

Will New York Law Go the Way of *Weedo*: Tenth Circuit Predicts New York Court of Appeals Will Hold that Property Damage Caused by a Subcontractor's Defective Workmanship Can Constitute an Occurrence Under a Contractor's CGL Policy

by Bryan C. Keane

On February 13, 2018, the Tenth Circuit Court of Appeals reversed a lower court decision, which concluded that, under New York law, the property damage caused by a subcontractor's faulty workmanship did not qualify as a covered occurrence because the only damages were to the EPC contractor's own work product. In *Black & Veatch Corporation v. Aspen Insurance (UK) Ltd.*, No. 16-3359, the Tenth Circuit disagreed, predicting the New York Court of Appeals "would join the clear trend among state supreme courts holding that damage from faulty subcontractor work constitutes an 'occurrence'" under a standard CGL policy.

Black & Veatch (B&V) was hired to engineer, procure, and construct jet bubbling reactors (JBRs), which eliminate contaminants from the exhaust from coal-fired power plants. As is a common scenario with EPC contractors, B&V subcontracted the engineering and construction of the internal components to Midwest Towers, Inc. ("MTI"). After work was completed on several reactors and work was ongoing on others, the project owner alleged it had sustained damages because deficiencies in the components procured and constructed by or on behalf of MTI caused internal components of the JBRs to deform, crack, and sometimes collapse.

B&V settled with the owner for \$225 million, and sought coverage for a portion of the settlement amount under its CGL policies. The primary insurer paid its limits, but the first level excess insurers, with limits of \$25 million, refused to indemnify B&V. The excess insurers claimed, in part, that the damages were solely to B&V's own work – the internal components of the JBRs (and, indeed, the entire project); according to the insurers, as a result, damage to those components does not constitute an "occurrence" under a CGL policy. And, without an "occurrence," there is no coverage.

New York law applied to the dispute, per the policy's language. B&V sued, and lost on

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summary judgment, with the lower court concluding that, under New York law, “damage arising from construction defects was not an ‘occurrence’ under the Policy unless the damage occurred to something other than B&V’s own work product,” which here was not the case. (The excess insurers raised several other defenses, including several exclusions, which the Tenth Circuit did not address as the lower court stopped at the conclusion that there was no “occurrence”).

On appeal, the Tenth Circuit analyzed whether the damage to B&V components, due to the actions of its subcontractor, could constitute an occurrence under New York law. The court looked at the policy’s language – explaining that to conclude that defective workmanship cannot constitute an occurrence would render several exclusions or exceptions to exclusions surplusage, in violation of New York law. The court also reviewed the evolution of the standard CGL policy, and in particular the “Your Work” exclusion and the “Subcontractor Exception” to the exclusion, noting the expansion of coverage over the years to include coverage to the contractor for damage caused by a subcontractor’s work.

In addition, the Court discussed that “[s]tate supreme courts that have considered the issue since 2012 have reached ‘near unanimity’ that ‘construction defects *can* constitute occurrences and contractors have coverage under CGL policies at least for the unexpected damage caused by defective workmanship done by subcontractors.” Finally, the court distinguished or dismissed as based on outdated policy language several decisions by intermediate New York courts, thereby concluding that such decisions do not preclude a conclusion that defective workmanship can constitute an occurrence.

Based on its methodical analysis, the court concluded that the damages at issue were caused by a coverage-triggering occurrence, and, as a result, remanded the case to the lower court for further proceedings.

While not a decision from the New York Court of Appeals itself, *Black & Veatch* is an important case for insureds in the construction industry. Construction contracts, especially on large projects, often specify application of New York law. And insurers – either based on case law or, as frequently is the case with policies originating from the London market, based on a contractual choice of law provision – often advocate for application of New York law to coverage disputes. And, if a claim arises, a common defense to coverage is that New York intermediate courts have concluded that defective workmanship is not an occurrence. But the Tenth Circuit has delivered at least a blow to that argument, and certainly a road map to dispute the argument.

The basic fact pattern in *Black & Veatch* is common in the construction industry: general contractor seeks coverage for damages caused by a subcontractor’s work. And the excess insurer’s response is also common. But, as the *Black & Veatch* court noted, in recent years there has been a shift in the courts in favor of the conclusion that defective workmanship can constitute an occurrence. Indeed, in 2016, the New Jersey Supreme Court overturned the “seminal case regarding the issue of whether CGL policies cover construction defects” – *Weedo v. Stone-E-Brick, Inc.* The *Black & Veatch* case provides a basis for believing that the interpretation under some New York cases, that defective

workmanship cannot be an occurrence, may go the way of *Weedo*.